IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1940.

No. 539.
STATE OF MINNESOTA, *Petitioner,*
vs.
DULUTH, MISSABE AND NORTHERN RAILWAY COMPANY, AND DULUTH, MISSABE AND IRON RANGE RAILWAY COMPANY, *Respondents.*

No. 540.
STATE OF MINNESOTA, *Petitioner,*
vs.
THE DULUTH AND IRON RANGE RAIL ROAD COMPANY AND DULUTH, MISSABE AND IRON RANGE RAILWAY COMPANY, *Respondents.*

No. 541.
STATE OF MINNESOTA, *Petitioner,*
vs.
SPIRIT LAKE TRANSFER RAILWAY COMPANY AND DULUTH, MISSABE AND IRON RANGE RAILWAY COMPANY, *Respondents.*

No. 542.
STATE OF MINNESOTA, *Petitioner,*
vs.
OLIVER IRON MINING COMPANY, *Respondent.*

No. 543.
STATE OF MINNESOTA, *Petitioner,*
vs.
PROCTOR WATER & LIGHT COMPANY, *Respondent.*

BRIEF OPPOSING PETITION FOR WRITS OF CERTIORARI.

ELMER F. BLU and CLARENCE J. HARTLEY,
700 Wolvin Building,
Duluth, Minnesota,
GEORGE W. MORGAN and CLEON HEADLEY,
E-1512 First National Bank Bldg.,
St. Paul, Minnesota,
Attorneys for Respondents.

KELLOGG, MORGAN, CHASE, CARTER & HEADLEY,
First National Bank Bldg.,
St. Paul, Minnesota,
Of Counsel.

Review Publishing Co., 141 E. Fifth St., St. Paul, Minn.

TABLE OF CONTENTS.

AUTHORITIES CITED.

STATUTES AND OTHER WORKS.

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1940.

No. 539.
STATE OF MINNESOTA,
Petitioner,

vs.

DULUTH, MISSABE AND NORTHERN RAILWAY COMPANY, AND DULUTH, MISSABE AND IRON RANGE RAILWAY COMPANY,
Respondents.

No. 540.
STATE OF MINNESOTA,
Petitioner,

vs.

THE DULUTH AND IRON RANGE RAIL ROAD COMPANY AND DULUTH, MISSABE AND IRON RANGE RAILWAY COMPANY,
Respondents.

No. 541.
STATE OF MINNESOTA,
Petitioner,

vs.

SPIRIT LAKE TRANSFER RAILWAY COMPANY AND DULUTH, MISSABE AND IRON RANGE RAILWAY COMPANY,
Respondents.

No. 542.
STATE OF MINNESOTA,
Petitioner,

vs.

OLIVER IRON MINING COMPANY,
Respondent.

No. 543.
STATE OF MINNESOTA,
Petitioner,

vs.

PROCTOR WATER & LIGHT COMPANY,
Respondent.

BRIEF OPPOSING PETITION FOR WRITS OF CERTIORARI.

The State claims that four federal questions were involved in the decisions of the Minnesota Supreme Court in the above entitled causes. Questions I and II as presented

by the State actually involve the same point and the State treated them together. We will consider the three questions in the order in which they are discussed by the State, combining the State's points I and II for treatment under our Point I.

POINT I.

THE DECISION OF THE MINNESOTA SUPREME COURT THAT THE SUMS OF $5,808,256.61 AND $1,966,547.58 RECEIVED BY THE DEFENDANT DULUTH, MISSABE AND NORTHERN RAILWAY COMPANY UNDER THE PROVISIONS OF THE "EMERGENCY RAILWAY TRANSPORTATION ACT, 1933" WERE NOT INCOME DERIVED FROM THE EXERCISE OF THE CORPORATE FRANCHISE FOR OTHER THAN RAILROAD PURPOSES DID NOT INVOLVE OR DEPEND UPON A CONSTRUCTION OF THE FEDERAL CONSTITUTION OR STATUTES, AND HENCE DID NOT DENY TO THE STATE RIGHTS UNDER SAID CONSTITUTION OR STATUTES; AND FURTHERMORE THE FEDERAL QUESTION, IF ANY, WAS NOT RAISED IN TIME.

The Minnesota Supreme Court construed the Minnesota Income Tax Act, as applied to corporations, as imposing a tax upon the corporate franchises, as property, and not upon income (R. pp. ~~1647-1648;~~ 1635-1636; 207 Minn. 618, 623, 292 N. W. 401, 404). It further held that

> "• • • railroads may not be subject to the franchise tax imposed by (the Minnesota Income Tax Act) measured by income from railroad ownership or operation because for such *exercise of the franchise* the gross earnings tax is exclusive, but that they are subject thereto insofar as the franchise is exercised, whether *ultra vires* or not, *for other* than railroad purposes." (Italics ours.) (R. pp. ~~1648-1649~~; 1636; 207 Minn. 618, 624, 292 N. W. 401, 404-405.)

The question therefore that the Minnesota Supreme Court had to, and did, decide with respect to these sums was whether they constituted income derived from an exercise of the defendant's corporate franchise for a non-railroad purpose. Put in slightly different language, the decision on this point involved a consideration of a question of fact, i. e., of the existence or non-existence on the part of the defendant with respect to these sums of any activity other than that of a carrier or railway corporation, which clearly in itself is not a federal question.

The Minnesota Supreme Court was concerned with the Transportation Act, 1920, Emergency Transportation Act, 1933, and the case of *Dayton-Goose Creek R. Co. v. United States*, 263 U. S. 456, only in so far as the same threw light upon the character of the defendant's use of its franchise with respect to these sums. This concern involved no construction of the acts, for they show upon their face and without need to resort to construction that they dealt with the defendant only as a "carrier" or railway corporation; and the same is true of the *Dayton-Goose Creek* case.

To test the matter we may assume the correctness of the State's construction of the federal acts referred to and the *Dayton-Goose Creek* decision, i. e., that the "recapture fund" never belonged to the defendant railway company, that it had no title or interest in the railway contingent fund in the hands of the Government, and no right to demand its return, prior to and except under the Emergency Transportation Act, 1933. How could the adoption of such a construction as opposed to some other construction affect the question of the character of the defendant's franchise activities, if any, with respect to these funds, or determine

that those activities were of a non-railroad character? Actually the Minnesota Supreme Court neither adopted nor rejected the State's construction. There is nothing in the Court's opinions essentially at variance therewith. However, the grounds of its decision with respect to these sums are set forth in the opinion of April 26, 1940, where there is first a restatement, for clarification, of the general test to be applied, as follows (R. p. ~~1820~~ 1817; 207 Minn. 637, 639, 292 N. W. 411, 412):

> "To avoid confusion for tax purposes, the distinction should lie between income derived from the exercise of the franchise within the scope of railroad ownership or operation and that from its exercise without such scope."

And later, specifically referring to the item of accretions and interest on the "recapture fund," an item which the Court had not felt it necessary to deal with in its earlier decision, the Court said (R. p. ~~1821~~ 1817; 207 Minn. 637, 639, 292 N. W. 411, 412-413):

> "It is obvious to us that the accretions and interest did not derive from the exercise of the corporate franchises for other than railroad purposes. The companies were compelled by law because they owned or operated railroads to pay part of their railroad earnings into this fund. The accretions and interest ensued as a result. They are necessarily and obviously a result of the exercise of the corporate franchises in the ownership or operation of railroads. To state the situation is to answer the contention. Had it not been for the exercise of the franchise for railroad purposes these funds would not have been accepted or repaid by the government."

Clearly these conclusions would have been reached by the State Court whatever construction might be placed, in the above mentioned respects, upon the federal acts and decision referred to and actually regardless of any question of construction.

That the "recapture funds" were created under a federal act and their character determined by a United States Supreme Court decision and that they were repaid under a federal act is all simply fortuitous. The creation, status and payment to the railroads of such funds might conceivably have been governed by non-federal legislation and non-federal court decisions or by no legislation or court decisions at all. The essential fact is that the payment was made in 1933 to a railroad company *qua* railroad company and because it was such at the time of the payment to the Government. This fact is what the Supreme Court of Minnesota determined and this is enough to demonstrate that these sums were not the result of an exercise of the railroad company's franchise for other than railroad purposes. The determination of this fact obviously involves no federal question.

The defendant paid the Minnesota state gross earnings tax for the years in which the "recapture funds" were originally received by the railroad on the amount of its gross earnings without deduction on account of payments to the Government under the recapture provision (R. pp. 797-800; 801-805) in accordance with the administrative construction of the Minnesota Gross Earnings Tax Law (R. pp. 801-802), a circumstance which accentuates the railroad character of the recapture funds, when originally received, and fortifies the inevitable conclusion that moneys repaid

to the defendant in 1933 did not involve any exercise of the defendant's franchise for a non-railroad purpose.

The State contends that both parties throughout the proceedings claimed and set up, as to these items, rights under the federal statutes. The State, to invoke this Court's jurisdiction, must indeed show that it claimed and set up such a right. The right that the State is claiming and setting up, and has claimed and set up throughout these proceedings, is the right to tax these sums under the Minnesota Income Tax Act, or include them in the measure of the tax. Of course, the most careful perusal or construction of the federal acts can disclose no provisions conferring or denying such a right. Thus it cannot be said that any rights under any federal act were set up or claimed in this litigation. The present case is quite different from *Jones National Bank v. Yates*, 240 U. S. 541, relied upon by the State, because there the liability created by the federal act was the very basis of the suit. On the contrary the present case is similar to such cases as *Allen v. Arguimbaugh*, 198 U. S. 149, and *Illinois v. Economy Power Co.*, 234 U. S. 497, where the federal statutes involved did not confer upon the complaining party any right nor afford a basis for his action or defense, and where this Court held there was no federal question.

The State (petition, pp. 13-14) asserts the defendant in paragraphs 10 and 12 of its answer alleged that the sums represented moneys received by the taxpayer from the United States Government under the provisions of the Emergency Transportation Act, 1933, but that such moneys did not constitute income of the defendant taxable under the Minnesota State Income Tax Act, among other reasons,

because they constituted a gift from the United States Government and/or income earned by the taxpayer in previous years. The State ignores the fact that preceding these paragraphs in paragraph 7, defendant alleged that the tax was invalid as applied to the defendant or its income, for the reason that (R. p. 291):

> "These defendants and their income and property are exempt from any tax under said Chapter 405 for the reason that they and their property, including franchises, are subject to the so-called gross earnings tax * * *."

In defendant's brief in the State Supreme Court the first and chief point urged with respect to these sums was under the caption "III. So-called nonoperating income cannot be taxed or used as a measure of a tax upon the railway franchises or privileges," and we said (Brief p. 60):

> "An examination of the items of 'so-called non-operating revenue' with respect to the defendant Duluth, Missabe and Northern Railway Company will show that none of them arises from business or activities of a nonrailroad character. These items, mentioned specifically by the State, are the principal amount of, accretions to and interest on the so-called recapture funds; * * *."
>
> "* * * The recapture moneys, including the accretions thereto and interest thereon, certainly do not arise out of the use of any nonrailroad property nor from any nonrailroad activity."

There followed in our brief, it is true, an alternative argument headed "IV. Even assuming that the defendants were subject to the Minnesota Income Tax Act, certain sums are not includable in taxing net income, i. e., * * *

(b) The so-called recapture fund, with accretions, repaid to the defendant Duluth, Missabe and Northern Railway Company." (Brief p. 84.)

Even the contentions stated as an alternative position in defendant's answer, paragraphs 10 and 12, and in its brief, Point IV just referred to, and the State's answer thereto, did not involve claiming or setting up a right under the federal statutes in question, and, furthermore, these contentions were not considered or passed upon by the State Supreme Court. As we have seen above, the State court adopted the first and primary contention of the defendant, i. e., that the sums were not the result of an exercise of the franchise of the defendant for other than railroad purposes and hence could not be used as a measure of a tax upon said franchise.

For a further reason, assuming for present purposes only the correctness of the State's position, it is clear there is no federal question involved with respect to these amounts. Section 2 of the Minnesota Income Tax Act, under which the State sought to impose the tax here in question upon the defendants, is as follows:

> "There is hereby imposed on every domestic and foreign corporation an annual tax for the privilege of existing as a corporation or of transacting any local business within this state during any part of its taxable year, measured by its taxable net income for such year, computed in the manner and at the rates hereinafter provided."

The privilege or franchise taxed is either the corporate franchise to exist or that to transact business. The defendant Duluth, Missabe and Northern Railway Company,

a domestic corporation, was created and existed only for railroad purposes and purposes incidental thereto (R. pp. 269-270), i. e., the corporate franchise "to be" was to be a railroad corporation. If, as the State claimed, the payment of these moneys by the Federal Government involves no *exercise* of the defendant's corporate franchise (State's Brief pp. 55, 56, 57-58), it does not follow that there was any exercise of the corporate franchise for *non-railroad* purposes but, on the other hand, it would follow that there was no exercise of any corporate franchise at all in the sense of transacting any business and the only corporate franchise that then would be taxed or taxable would be the corporate franchise "to be" a railroad corporation. Since that corporate franchise to be cannot be taxed under the Minnesota Income Tax Act for the reasons heretofore referred to, and since there would be involved, on the State's theory, no exercise of any corporate franchise to do, clearly the moneys in question could not be used as a measure of a franchise tax at all.

However, the presence or absence of a federal question does not depend upon the correctness or incorrectness of the State Court's interpretation of the Income Tax Act and its definition of the subject matter taxed. So the State does not advance its claim for a writ of certiorari by arguing that there was no exercise at all of the defendant's franchise to do business, this involving, as we have seen, no federal question.

The alleged right under the federal statutes now asserted by the State was in fact asserted for the first time in its Supplement to its Petition for Rehearing (pp. 55 and 76). The petitions were denied and no rehearing granted, and

in its opinion denying the petitions the State court made no reference to, and did not consider or pass upon, the State's claim (R. p. ~~1819~~ 1815; 207 Minn. 637, 292 N. W. 411). Hence the claim is not only without merit but was set up too late. See *St. Louis & San Francisco R. Co. v. Shepherd,* 240 U. S. 240; *American Surety Co. v. Baldwin,* 287 U. S. 156; *McMillen v. Ferrum Mining Co.,* 197 U. S. 343; and *Waters-Pierce Oil Co. v. Texas,* 212 U. S. 112.

POINT II.

THE DECISION OF THE MINNESOTA SUPREME COURT THAT SECTION 32 (c) OF THE MINNESOTA INCOME TAX LAW REQUIRED, INSTEAD OF MERELY PERMITTING, THE COMPUTATION OF THE TAX OF AFFILIATED CORPORATIONS UPON THE COMBINED NET INCOME BASIS, WAS NOT BASED SOLELY OR PRIMARILY UPON CONSTITUTONAL GROUNDS, EITHER STATE OR FEDERAL, BUT UPON ITS CONSTRUCTION OF THE LAW DERIVED FROM (a) A STUDY OF LEGISLATIVE INTENT, AND (b) THE APPLICATION OF GENERAL CANONS OF CONSTRUCTION.

The State admits that the decision of the Minnesota Supreme Court upon the question now considered was based upon non-federal grounds, but argues that these were not adequate or independent grounds, and that the Minnesota Supreme Court was driven to its decision by the fact that if the word "may" were construed as permissive it would result in a violation of the United States Constitution, and that therefore a federal question is presented.

Even a cursory examination of the Minnesota Supreme Court's opinion shows that the State's contention is without foundation. At the very commencement of that opinion (after three short paragraphs stating the nature of the case and the general question presented) the Court said (R. p. ~~1655~~ 1672; 207 Minn. 630, 632, 292 N. W. 407, 408):

> "Decision of the controversy lies *in the proper construction* of subd. (c) of § 32 of c. 405 * * *." (Italics ours.)

Then the bulk (about four and a half pages of the Minnesota reports) of the remaining portion of the opinion is devoted to considering the proper construction of the word

"may" as derived from legislative intent and from ordinary rules of statutory construction. In the course of the consideration of these non-federal grounds for the decision, the Minnesota Supreme Court expressly introduced one part of its discussion with the phrase "Constitutional questions for the present aside" (R. p. ~~1658~~ 1645, 207 Minn. 635, 292 N. W. 410).

It was not until it had dealt fully with the non-federal and non-constitutional grounds of its decision, that the Minnesota Supreme Court took up in one very brief paragraph the constitutional difficulties that would arise if the word "may" were not given a mandatory meaning (R. p. ~~1660~~ 1647, 207 Minn. 636, 292 N. W. 410). Even then they dealt independently with adequate State constitutional objections as well as federal.

The State court reached its conclusion that the word "may" is mandatory independently and in the first instance by several channels, none of them involving constitutional objections, to-wit:

(1) Legislative intent as derived from legislative history (R. pp. ~~1656-1658~~ 1642-1644, 207 Minn. 632, 634, 292 N. W. 409, 410). After a lengthy review of the history of the Wisconsin law, from which the Minnesota section was taken, including court decisions construing the Wisconsin law (*Cliffs etc. Co. v. Tax Commission*, 193 Wis. 295, 214 N. W. 447; *Curtis Co. v. Wisconsin Tax Commission*, 214 Wis. 85, 251 N. W. 497), it arrived at the following conclusion (R. p. ~~1658~~ 1644, 207 Minn. 634, 292 N. W. 410):

> "It seems obvious that with that litigation in mind the Minnesota legislature attached the last sentence of subd. (c) for the purpose of making the powers and duties of the Minnesota tax commission clear; that it

sought to give the Minnesota commission the power the Wisconsin commission claimed."

(2) Legislative intent as derived from the fact that the act would be "obviously fair and * * * under normal conditions would be profitable to the state" if the word "may" was mandatory. The Court said (R. p. ~~1658~~ 1645; 207 Minn. 634, 292 N. W. 410):

"We are convinced that our legislature intended the imposition of a tax upon the affiliated corporations described in the last sentence of § 32 (c) as if they were but one corporation, a provision which is obviously fair and which under normal conditions would be profitable to the state as imposing a higher rate of taxation. It is clear that such a construction of the tax is normally in the interest of the state. Where graduated surtaxes are imposed, any other construction of the act would be unfair to the state as permitting what is actually one taxpayer to be divided into several so that a lower rate would be applicable."

(3) Legislative intent as derived from the fact that subdivisions (a) and (b) of Section 32 provide penalties which the legislature intended for tax evasion by corporations, whereas subdivision (c) of that section was not of a "penalty" character (R. pp. ~~1658-1659~~ 1645-1646). The Court said (R. p. ~~1659~~ 1645; 207 Minn. 635, 292 N. W. 410):

"To us it seems clear that the legislature intended a tax always to be imposed and not a penalty for some undefined evasion."

(4) Legislative intent as disclosed by the fact that by the first sentence of subdivision (c) the Tax Commission is empowered and "we think compelled" to require and

permit consolidated tax statements from affiliated or related corporations for the purpose of determining the taxable income of any one of such corporations. As to this the Minnesota Supreme Court said (R. p. ~~1650~~ 1645-1646; 207 Minn. 635, 292 N. W. 410):

> "By the first sentence of subd. (c) the tax commission is empowered and we think compelled to require and permit consolidated tax statements from affiliated or related corporations for the purpose of determining the taxable income of any one of such corporations, and we think it makes plain common sense and discloses the obvious intent of the legislature to interpret the word 'may' in the last sentence as 'shall' and thus to require the imposition of one income tax upon a group of affiliated corporations where 90 per cent or more of the voting stock is held by one interest."

(5) The application of the general rule of statutory construction that "where a power is conferred to be exercised for the benefit of the state or a private party the word 'may' is to be construed to mean 'must' and the statute is mandatory" (R. p. ~~1660~~ 1646; 207 Minn. 636, 292 N. W. 410).

At the end of the four and one-half pages of discussion the State Supreme Court at this point had conclusively demonstrated upon the grounds of general statutory construction that the word "may" should be construed as mandatory in the context of the act. It was only then that it proceeded at all to consider constitutional objections in the short paragraph immediately following.

The Court held that if the word "may" were construed as permissive, there would be "an unconstitutional dele-

gation of legislative powers," citing a decision by this Court, but without specifying whether the delegation would violate the Federal Constitution or the State Constitution, or both.

The Court further concluded (R. p. ~~1660~~ 1646; 207 Minn. 636, 292 N. W. 411):

> "There would also be a lack of uniformity which would violate our constitutional requirements (Minn. Const. art. 9, § 1, *as well as* U. S. Const. Amend. XIV) if discrimination resulted." (Italics ours.)

The Court here clearly gave as an independent and adequate ground of constitutional objection the violation of the State, as distinguished from the Federal, Constitution.

POINT III.

THE DECISION OF THE MINNESOTA SUPREME COURT THAT SECTION 12 OF THE MINNESOTA STATE INCOME TAX ACT, BECAUSE OF ITS EXCLUSION OF INCOME FROM STATE AND LOCAL SECURITIES, VIOLATES THE IMMUNITY FROM TAXATION OF FEDERAL SECURITIES UNDER THE UNITED STATES CONSTITUTION BY ITS INCLUSION OF INCOME FROM FEDERAL SECURITIES IN THE MEASURE OF THE TAX, DOES NOT AFFORD A GROUND FOR GRANTING A WRIT OF CERTIORARI.

There are three reasons why the decision of the Minnesota Supreme Court holding that income from federal securities could not be included in the measure of the Minnesota Income Tax Act does not afford a ground for granting the writs of certiorari sought by this petition. We will discuss them separately.

A. The question is moot because, even if the income from federal securities were included in the measure of the tax as against the defendants, there would be no tax against the defendants or affiliated companies when computed upon the combined net income basis provided for by Section 32 (c) of the Act.

It is, of course, settled that this Court will not take jurisdiction, even where a federal question is involved on the face of the record, if in fact the question is insubstantial in the sense that its decision could not affect the disposition of the case. Thus this Court will not decide a question which has become moot, *Shaffer v. Howard*, 249 U. S. 200; *Commercial Cable Co. v. Burleson*, 250 U. S. 360, nor one which, in the circumstances, is hypothetical. *City of Cincinnati v. Vester*, 281 U. S. 439, 448; *Abrams v. Van Schaick*, 293 U. S. 188; *Tennessee Publishing Co. v. American Nat.*

Bank, 299 U. S. 18, 22; *Anniston Mfg. Co. v. Davis*, 301 U. S. 337, 355.

Here, assuming that there is a federal question involved and that this Court might reverse the State Court decision with respect to it and hold that there should be included in the measure of the tax income received from federal securities, there would be taxable income chargeable to the two defendants Duluth, Missabe and Northern Railway Company and The Duluth and Iron Range Rail Road Company in the aggregate sum of $364,110.24 (State's petition p. 33).

However, the State Supreme Court said (R. p. ~~1655~~ 1642, 207 Minn. 630, 631; 292 N. W. 408):

> "It so happens in this case that if they (the affiliated corporations) be taxed as one corporation their losses are such that they have no taxes to pay, whereas if they be severally assessed for the taxes in question some of the corporations will be liable for a tax."

And again (R. p. ~~1823~~ 1819; 207 Minn. 637, 642, 292 N. W. 411, 414):

> "As we compute the net deficit from the figures in the state's brief, it is, in view of our holdings as to what is taxable under c. 405, something in excess of $900,000."

As a matter of fact the record shows that not only was the net deficit in excess of $900,000 but greatly in excess thereof. It is to be remembered that the State Supreme Court had held that Section 32 (c) of the Act as construed by the Court *required* the Minnesota Tax Commission to impose the tax as though the combined entire taxable net income of the defendants and their affiliated corporations was that

of one corporation and hence to set off the deficit of one corporation against the income of others.

Thus it is clear that even if the $364,110.24 here involved be included in the measure of the tax it would merely reduce the "net deficit" of the affiliated companies from something in excess of $900,000 to something in excess of $500,000.

It would therefore be an empty gesture for this Court to take jurisdiction of the cases here involved, upon this point, even assuming that there was any substantial federal question involved and even assuming further that this Court might decide it favorably to the State, because such a decision by this Court would not result in the recovery by the State of any tax whatsoever either from the defendants here involved or any of their affiliated companies.

We shall proceed to show, however, that there is no substantial federal question involved.

B. The decision was in accord with the decisions of this Court and hence no substantial federal question was involved.

The granting of a writ of certiorari is not a matter of right but of privilege. One of the reasons that may incline this Court to grant a writ is that a decision of the highest court of the State is not in accord with applicable decisions of this Court. Here, assuming that a federal question was involved, the Minnesota Supreme Court has decided it in accordance with such decisions.

Briefly stated, the State Supreme Court decision on the point here involved held that, interest upon obligations of the State of Minnesota and of its political or governmental subdivisions being excluded from the measure of the tax, income received from the United States could not be in-

cluded, because to do so would in the circumstances violate the immunity from discriminatory taxation enjoyed by the latter income under the Federal Constitution.

Section 12, subsection (f), of the State act expressly excludes the interest from State and local obligations. Subsection (g) of the same section expressly excludes income received from the United States, but subsection (1) by providing that subsection (g) shall not apply to corporations taxable under section 2, i. e., subject to the corporate franchise tax like the defendants in this case, expressly puts back into the measure of the tax such income received from the United States. Of the eleven categories of exemptions provided for in section 12, it is to be noted that only this single class is put back into the measure of such tax.

Although the State Supreme Court in its opinion did not expressly mention subsection (1), the decision which it arrived at with respect to the inclusion of income received from the United States is the only conclusion that could have been reached, and obviously the conclusion that the Court would have reached, had it expressly considered subsection (1) and its effect.

Among the exemptions the State Supreme Court found that the category of interest upon obligations of the State and its political subdivisions was from sources in substantial competition with federal securities (R. pp. 626, ~~1650, 1651~~; 1637-1638 207 Minn. 618, 626, 627, 292 N. W. 406). (Minnesota Tax Commission's Report 1934, p. 126, showing outstanding on December 31, 1932, State and local securities exempt from the tax measure of upwards of $334,000,000.) The Court concluded that this resulted in unlawful discrimination against federal securities under the decisions of this Court, i. e., *Miller v. Milwaukee*, 272 U. S. 713, and *Schuylkill*

1638

Trust Co. v. Pennsylvania, 296 U. S. 113 (R. p. ~~1650~~; 207 Minn. 626, 292 N. W. 406). The Court might also have cited, to the effect that the State cannot impose a discriminatory tax upon income from federal securities nor use the same as a measure of a tax in a discriminatory way, *Helvering v. Mountain Producers Corporation*, 303 U. S. 376, 385; *Helvering v. Gerhardt*, 304 U. S. 405, 413, 420; *Graves v. New York*, 306 U. S. 466, 480, 488; and *Tradesmens National Bank v. Oklahoma Tax Commission*, 309 U. S. 560, 566.

This Court's decisions hold, and of course we do not dispute, that if the tax is a privilege tax measured by income (as is the case here) it is not subject to objection that income from tax-exempt federal securities is included in the measure of the tax, *if* the tax is measured by all income regardless of source and is not discriminatory as against income from federal sources.

In *Pacific Company v. Johnson*, 285 U. S. 480, involving the validity of a California privilege tax upon corporations measured by income including all interest received from federal, state, municipal or other bonds (p. 488), the question was whether the tax could be measured by income "without discrimination as to its source" (p. 490) and this Court, distinguishing the case of *Miller v. Milwaukee*, 272 U. S. 713, pointed out (p. 493) that the Wisconsin Act there involved did more than exhibit the intention of the state sovereignty to include in the dividends taxed those derived from income from an instrumentality of the other

> "*together with income from all other sources.* That admittedly would have been permissible." (Italics ours)

The opinion proceeds (p. 493):

> "Thus, in our dual system of government, action of the one government in the proper exercise of its sovereign powers, regarded as innocuous and permissible notwithstanding its incidental effects on the other, may become offensive and be deemed forbidden if it *discriminates* aganst the other. State taxes which, if *nondiscriminatory,* would be upheld, even though they reach or affect those engaged in interstate commerce, are condemned if they *discriminate* against those so engaged, by placing on them heavier burdens than imposed on others within the state." (Italics ours)

With respect to the California statute the Court concludes (p. 496):

> "As it operates to measure the tax on the corporate franchise by the *entire net income* of the corporation, *without any discrimination* between income which is exempt and that which is not, there is no infringement of any constitutional immunity." (Italics ours)

In *Tradesmens National Bank v. Oklahoma Tax Commission,* 309 U. S. 560 (decided March 25, 1940), involving the validity of a state franchise tax on a national banking association measured by the entire net income including interest upon obligations of the United States, this Court, after referring to authorities, including *Pacific Co. v. Johnson, supra,* and *Miller v. Milwaukee, supra,* said of the State tax act (p. 566):

> "It has effected its purpose by including within the measure of its franchise tax on national banks *the entire net income without respect to source and without discrimination against tax-exempt federal securities.*" (Italics ours)

and the Court then proceeded to hold that the statute merited the tests stated in *Pacific Co. v. Johnson, supra,* quoting the language above quoted from that case.

In *Schuylkill Trust Co. v. Pennsylvania,* 296 U. S. 113, a statute of Pennsylvania imposing a tax upon the capital stock of corporations measured by "so much of the net assets as is not represented by shares of Pennsylvania corporations already taxed or exempt from tax" (p. 117) was attacked as discriminating against United States securities because such securities were not deducted at their full value. The Court held that *if,* under the State law, shares of stock of Pennsylvania corporations or assets declared exempt by State law are taken out of assets in computing the tax, then it is a discrimination against federal securities if such securities are included. This Court speaking through Mr. Justice Roberts, said (p. 120):

> "If the tax is lifted from the shares of certain trust companies because those companies own only stocks already taxed or relieved from taxation by the State, and shares in other trust companies are taxed amongst whose assets there are United States bonds or other securities entitled to exemption because issued by federal instrumentalities which are figured in the base of the tax, it is impossible to avoid the conclusion that the law *discriminates* in favor of the former and against the latter solely by reason of ownership of such federal securities." (Italics ours)

The decision of the State Court sustaining the tax was reversed. In his dissenting opinion Mr. Justice Cardozo, while finding no forbidden discrimination in the case, recognized that in certain circumstances discrimination would invalidate the tax, saying (p. 129):

> "The discrimination, as has been said, must be so marked as to justify the inference that it was unfriendly in design or at the very least it must favor forms of investment that are in substantial competition with government securities."

Thus the majority opinion held that any discrimination against federal securities was invalid and even the minority took the view that discrimination was unlawful which was either unfriendly in design or in favor of securities in substantial competition with federal securities included in the tax base. In the instant case we have the discrimination condemned by the majority and also a discrimination unfriendly in design and in favor of State securities in substantial competition with federal securities.

While certain recent decisions of this Court tend to limit the immunity from taxation by the respective sovereignties, Federal or State, of the income received by the taxpayer from the other sovereignty, the decisions emphatically lay down the rule that the tax must not be discriminatory.

Thus in *Helvering, Commissioner v. Mountain Producers Corp.*, 303 U. S. 376, this Court, speaking through Mr. Chief Justice Hughes, said (p. 385):

> "We have always recognized that no constitutional implications prohibit *a non-discriminatory* tax upon the property of an agent of government merely because it is the property of such an agent and used in the conduct of the agent's operations and necessary for the agency."

In *Helvering, Commissioner v. Gerhardt*, 304 U. S. 405, this Court, speaking through Mr. Justice Stone, referring

to the case of *McCulloch v. Maryland,* 4 Wheat, 316, said (p. 413):

> "It was perhaps enough to have supported the conclusion that the tax was invalid, *that it was aimed specifically at national banks and thus operated to discriminate* against the exercise by the Congress of a national power. *Such discrimination* was later recognized to be in *itself* a sufficient ground for holding invalid any form of state taxation adversely affecting the use or enjoyment of federal instrumentalities. *Miller v. Milwaukee,* 272 U. S. 713; cf. *The Pacific Co., Ltd. v. John-on,* 285 U. S. 480, 493." (Italics ours)

The Court then proceeded to hold valid the imposition of the federal income tax upon the compensation of employees of the Joint Port Authority of the States of New York and New Jersey, saying (p. 420):

> "A *non-discriminatory tax* laid on their net income, *in common with that of all other members of the community,* could by no reasonable probability be considered to preclude the performance of the function which New York and New Jersey have undertaken, or to obstruct it more than like private enterprises are obstructed by our taxing system." (Italics ours)

Mr. Justice Black in his concurring opinion also points out that the tax is a *non-discriminatory* tax upon income from the state.

In *Graves v. New York,* 306 U. S. 466, the question was as to the authority of the State to impose a tax upon the income of an employee of the Home Owners' Loan Corporation. Mr. Justice Stone in the opinion said (p. 480):

> "The present tax is *a non-discriminatory tax* on income applied to salaries at a specified rate." (Italics ours)

The tax was sustained because it was "a non-discriminatory general tax" (p. 487).

Mr. Justice Frankfurter in his concurring opinion said (p. 488):

> "Since two governments have authority within the same territory, neither through its power to tax can be allowed to cripple the operations of the other. *Therefore state and federal governments must avoid exactions which discriminate against each other or obviously interfere with one another's operations.* These were the determining considerations that led the great Chief Justice to strike down the Maryland statute as an unambiguous measure of discrimination against the use by the United States of the Bank of the United States as one of its instruments of government." (Italics ours)

As we have seen, the Minnesota Income Tax Act excludes from the measure of the tax a large number of items of income, among them interest upon State and municipal bonds. So long as the State measures the tax by income without regard to the source, it may include income from federal securities in the measure of the tax. That is as far as the State has the power to go in including income from that source in the measure of the tax. Otherwise the tax is subject to the constitutional objection that it violates the provisions of the Fourteenth Amendment to the Constitution of the United States, particularly in that it denies the equal protection of the laws and because it invades the immunity from discriminatory taxation of activities of the Federal Government.

The decision of the Minnesota Supreme Court was not only in accordance with, but the necessary result of, the

decisions of this Court just cited, and hence no meritorious federal question is here presented by the petitioner.

C. The Minnesota Supreme Court could and clearly would have excluded the income from federal securities here in question from the measure of the tax on a non-federal ground, i. e., that the same did not result from the exercise of the corporate franchise for a non-railroad purpose, if it had not considered the inclusion of the sums discriminatory.

Respondents recognize that the mere fact that the State Court *could* have reached the same conclusion upon an independent non-federal ground would not be sufficient to justify this Court in refusing to take jurisdiction provided that a meritorious federal question were involved. However, when upon the very face of the decisions of which petitioner seeks review it appears, as here, that the State Supreme Court not only could, but inevitably would, reach the same conclusion, i. e., that the income in question could not be included in the measure of any tax upon the franchises of the defendants, upon an independent and adequate non-federal ground, it is a circumstance which this Court will wish to take into consideration in determining whether it should grant the writ sought, that being a matter of privilege and not of right.

An examination of the Supreme Court opinions discloses that with respect to substantial sums on deposit with the United States Steel Corporation, the State Court held that interest thereon was railroad income and hence could not be included in the measure of the tax. The same was true of all other items of so-called "non-operating" income considered including interest on bank deposits, working capi-

tal, income from houses rented and sold to employees, etc. (R. pp. ~~1821-1822~~ 1817-1818; 207 Minn. 637, 640; 292 N. W. 411, 413).

In the same category were the federal securities. It appears without dispute (R. pp. 908-909, 910, 912, 921) that in the case of the Duluth, Missabe and Northern Railway Company a substantial part of the income from federal securities was derived from United States bonds held as a part of the so-called Railroad Transportation Fund by the defendant, as a carrier, under the provisions of the Transportation Act of 1920 and that all of the said federal securities were held by the defendant for railroad purposes just like the other portions of the funds expressly passed on by the Court, mentioned in the preceding paragraph. Furthermore, the record shows (p. 921) that the defendant Duluth, Missabe and Northern Railway Company was engaged solely in railroad activities.

It appears without dispute (R. p. 968) that in the case of The Duluth and Iron Range Rail Road Company all of the federal securities from which the income in question was derived were held for railroad purposes.

There is no evidence, no findings of fact and no suggestion in the opinions of either the trial Court or the Minnesota State Supreme Court that either of the defendant railways was engaged in non-railroad activities of any kind.

The State Supreme Court having held that income from other portions of this same fund was not derived by the defendants from the exercise of their franchises for non-railroad purposes and the evidence being uncontradicted that the interest here in question was of the same category,

the State Court would inevitably hold that these items of interest on federal securities were likewise from a non-railroad activity.

CONCLUSION.

For the foregoing reasons this Court should deny the petition for writs of certiorari to review the final judgments of the Supreme Court of the State of Minnesota in the above entitled actions and each of them.

Respectfully submitted,

ELMER F. BLU,
CLARENCE J. HARTLEY,
CLEON HEADLEY,
GEORGE W. MORGAN,
Attorneys for Respondents.

KELLOGG, MORGAN, CHASE,
CARTER & HEADLEY,
Of Counsel.

November 20, 1940.